

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)
)
)

RBOC Payphone Coalition Petition for)
Rulemaking To Establish Revised Per-Call)
Payphone Compensation Rate)

RM No. 10568

)
American Public Communications Council)
Request To Update Default Compensation Rate for)
Dial-Around Calls from Payphones)
_____)

COMMENTS OF AT&T CORP.

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COMMENTS OF AT&T CORP.

Pursuant to 47 C.F.R. §§ 1.405, 1.430, AT&T Corp. ("AT&T") submits these comments in response to the Commission's Public Notice, DA No. 02-2381, regarding Petitions for Rulemaking Regarding Payphone Dial-Around Compensation Rate.¹

INTRODUCTION

In light of alleged significant changes in market conditions, the American Public Communications Council ("APCC") and the RBOC Coalition (collectively, "Petitioners") request that the Commission increase the default rate for payphone calls from \$0.24 per completed call to \$.0484 or \$0.49 per completed call, respectively.

¹ See RBOC Payphone Coalition's *Petition For Rulemaking To Establish Revised Per-Call Payphone Compensation Rate*, Petition for Rulemaking (filed Sept. 4, 2002) ("RBOC Petition"); American Public Communications Council's *Request to Update Default Compensation Rate For Dial-Around Calls from Payphones*, Request That The Commission Issue A Notice Of Proposed Rulemaking (Or In The Alternative, Petition For Rulemaking) To Update Dial-Around Compensation Rate (original filed on Aug. 29, 2002; corrected copy filed Aug. 30, 2002) ("APCC Petition").

AT&T submits that the Commission should deny Petitioners' request and issue a Notice of Inquiry ("NOI") to address whether and to what extent significant changes have taken place in the payphone market that may warrant a different and more appropriate regulatory response to "promote competition among payphone service providers" and to "promote the widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1). There can be little doubt that the Commission will not promote the widespread deployment of payphones or benefit the general public by acceding to Petitioners' requests to double the default rate of compensation for payphone calls. To the contrary, that approach could only serve to diminish the current demand for payphone services and thereby harm the same low-income payphone customers that APCC purports to champion.

As a result, the Commission should develop a regulatory approach that properly considers the decline in consumer demand for the use of payphones. Such an approach would promote the deployment of payphones for the public benefit and thus comply with the mandate set forth in the Telecommunications Act. 47 U.S.C. § 276(b)(1). Specifically, the Commission should issue an NOI to (i) analyze the current state of the payphone market, (ii) determine the appropriate level of payphone deployment and compensation in light of changing market conditions, and (iii) assess what is the most efficient means of cost recovery consistent with the requirements of Section 276 and developing market conditions.

However, even if the Commission concludes it is appropriate to adhere to the methodology adopted in the *Third Report & Order*,² the Commission should reject Petitioners' proposals. The *Third Report & Order* adopted a per-call payment methodology that relied on the

² *In re Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Third Report & Order, And Order On Reconsideration of the Second Report & Order, 14 FCC Rcd. 2545 (1999) ("*Third Report & Order*").

number of calls at a “marginal payphone” location as well as the joint and common costs associated with a marginal phone. Both APCC and the RBOC Coalition contend that they largely have applied that methodology with “small modifications.” *RBOC Petition* at 2; *cf.* *APCC Petition* at 2-3, 13 n.20. But the “modifications” that Petitioners have proposed reflect significant changes both to the call-volume standards adopted by the Commission as well as to the determination of compensable costs.

As to call volume, both APCC and the RBOC Coalition abandon the analysis that the Commission adopted in the *Third Report & Order* and that the D.C. Circuit affirmed on appeal. Their proposed alternatives have the effect of increasing the default compensation rate by minimizing their estimates regarding the number of calls necessary to allow a payphone to recoup its costs. As to costs, even a cursory analysis of their current tentative estimates³ reveals that both APCC and the RBOC Coalition have sought to inflate their per payphone cost estimates in ways that have been foreclosed by both the Commission and the D.C. Circuit. *See* Part II.B., *infra*. The unreasonableness of these proposals is confirmed by analyzing them, as did the Commission in the *Third Report & Order*, through a top-down validation based upon the unregulated market rate for payphone coin calls. *See* Part II.C., *infra*.

³ *See APCC Petition*, Attach. A, at 2 n.1 (explaining that APCC’s “data collection efforts are continuing” and that “revised results will be provided as additional information becomes available”).

ARGUMENT

I. THE COMMISSION SHOULD INITIATE A NOTICE OF INQUIRY TO ASSESS THE IMPACT THAT CHANGES IN THE TELECOMMUNICATIONS MARKET HAVE HAD ON THE PAYPHONE INDUSTRY.

The Commission should initiate a Notice of Inquiry to assess the changes that have occurred in the telecommunications market, the impact that those changes have had on the payphone industry, and the manner in which the Commission can best promote the purposes underlying Section 276.

A. The Commission Can And Should Reassess Its Regulatory Policy Regarding The Proper Means To Satisfy The Public Interest And The Goals Underlying Section 276 In Light Of Changing Market Conditions.

By its terms, Section 276 is designed to promote both “competition among payphone service providers” and the “widespread deployment of payphone services to the benefit of the general public.” 47 U.S.C. § 276(b)(1). It requires the Commission to “establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every completed intrastate and interstate call using their payphone.” *Id.* In the *Third Report & Order*, the Commission concluded that Section 276 required the Commission to “balance the interest of PSPs and those parties that will ultimately pay the default compensation amount” and to “ensure that the default compensation amount is sufficient to support the continued widespread availability of payphones for use by consumers.” *Id.* ¶ 55. The Commission reasoned that because “each type of call has a relatively small marginal cost, a wide range of compensation amounts may be considered ‘fair.’” *Id.* ¶ 56.

Based upon the evidence in the record in early 1999, the Commission concluded that “the current approximate level of payphone deployment most appropriately satisfies Congress’s stated goal of promoting widespread deployment of payphones to the benefit of the

general public.” *Id.* ¶ 143. That conclusion, in turn, was supported by “the filings of several states that have studied the payphone markets in their respective jurisdictions and concluded that the current deployment of payphones is adequately meeting the needs of the public.” *Id.* Specifically, the Commission relied on the findings by state utilities commissions that had “examin[ed] the payphone markets” within their respective jurisdictions and found the number of payphones then in place to be “sufficient.” *Id.* ¶ 141.

This premise – that the public’s communications needs required preservation of 1999 levels of payphone deployment – led the Commission to build its compensation system for dial-around calls on the economics of the “marginal” payphone. Such an approach, the Commission reasoned, would establish “fair compensation for the overwhelming majority of payphones” and therefore “ensure the continued deployment of existing payphones to the greatest practical extent.” *Id.* ¶ 15.⁴

Petitioners acknowledge that the telecommunications market is significantly different today than it was at the time of the *Third Report & Order*. Specifically, they contend that the public’s demand for payphone service has been diminished by the pervasiveness of affordable cellular technology.⁵ Of course, the decline in demand for payphone services cannot

⁴ Accordingly, the Commission established a \$0.24 default rate for dial-around calls by calculating the “joint and common” monthly costs for a typical payphone and dividing them by the number of calls per month placed at a “marginal [payphone] location.” *Id.* ¶ 191. It defined a marginal payphone location as one where “the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner.” *Id.* ¶ 139.

⁵ See *RBOC Petition* at 1 (citing “extraordinary decline in the volume of payphone calls due to the proliferation of wireless telephones”); *id.*, attachment at 10 (“As expected, the number of [payphone] stations had decreased from prior years, due largely to wireless penetration and affordability”); *APCC Petition* at 1 (“market conditions have indeed changed substantially since the *Third Report and Order*”); *id.* at 7 (“The dramatic expansion of wireless services has had the effect of reducing the overall volume of calls made at payphones.”).

be separated from the dramatic rate increases of recent years and the dramatic decrease in the costs of wireless communications services. As APCC noted previously, drops in payphone call volume can be attributed “to the drop in cellular and PCS prices.” *Id.* ¶ 140. Indeed, the Commission has noted that, in light of reductions in the price for wireless services, consumers increasingly are relying upon those services where they previously relied upon wireline services.⁶

In the face of this new competition, however, the cost of an unregulated coin call has increased from a range of \$ 0.25 to \$ 0.35 several years ago to today’s \$ 0.50. *See RBOC Petition* at 2. Thus, Petitioners acknowledge that it is not just the *presence* of cellular technology that has limited the demand for payphones, but also the relative costs of the two communications services. *See RBOC Petition*, attachment at 10 (“As expected, the number of stations had decreased from prior years, due largely to wireless penetration *and affordability.*”) (emphasis added).

Here, the positions advanced by APCC and the Coalition, if accepted, undoubtedly will decrease the demand for dial-around payphone services. If the default rate for dial-around payphone calls increases, the cost of a payphone call will increase not only for IXC’s, but also for their consumers. APCC ignores that fact when it implies that its proposed rate increase is motivated by a desire to meet the telecommunications needs of low-income

⁶ *In re Implementation of Section 6002(B) of the Omnibus Budget Reconciliation Act of 1993*, Seventh Report, 17 FCC Rcd. 12985, 13012 (2002) (“Seventh Report”) (citing research showing that per-minute prices for mobile telephony in the 25 largest American cities declined 7.3 percent in 2001, following a 6.9 percent decline in 2000); *In re Implementation of Section 6002(B) of the Omnibus Budget Reconciliation Act of 1993*, Sixth Report, 16 FCC Rcd. 13350, 13377 (2001) (prices fell 25 percent in 1999); Seventh Report, 17 FCC Rcd. at 13017 (noting that three to five percent of wireless customers now use their wireless phone as their only phone); *id.* at 13012 (“there is growing evidence that consumers are substituting wireless service for traditional wireline communications”).

individuals. *APCC Petition* at 6 (“Payphones are most critical for the third category of user – those who not only cannot afford a wireless phone, but who cannot even afford a home phone.”). These same low-income payphone users would end up shouldering much of the doubled dial-around rate APCC proposes.⁷

Section 276 does not mandate this absurd result or require the Commission to freeze into place policies designed to ensure the profitability of an arbitrary number of payphones regardless of changes in market conditions. To the contrary, the Commission is required to “promote the widespread deployment of payphone services” not without regard to public demand, but for “the benefit of the general public.” 47 U.S.C. § 276(b)(1). If much of the “general public” already has adopted an alternative to payphones, then there can be no rational basis for insisting that the current number of payphones must be maintained or that the Petitioners’ claims that there has been a decrease in the number of available payphones requires the Commission to increase (let alone double) the default compensation rate.

Simply put, the *Third Report & Order* makes clear that the Commission is not obligated to adhere to an approach that can only significantly diminish consumer demand for payphone services. Where, as here, changed market conditions may compel another approach to

⁷ This disproportionate impact is illustrated by the market for prepaid calling cards, which has increased dramatically in recent years, see *Prepaid Phone Usage From the Customer’s Perspective*, Customer Perspective Research Group, L.L.P. (2002) at 4 (annual revenues of industry have grown from \$12 million in 1992 to \$3.4 billion). These cards are particularly popular among low-income households. In fact, sixty percent of low-income people who buy prepaid calling cards buy a card at least once a month. See *id.* at 13-14. One-third of all prepaid phone card users use the cards at payphones. See *id.* at 24.

promote the public interest and the deployment of payphones for the public benefit, the Commission should revisit its existing rules.⁸

B. The Commission Should Issue A Notice Of Inquiry To Assess The Changes In Market Conditions And Their Impact On The Public's Demand For Payphone Services.

The Commission should adopt a Notice of Inquiry designed to assess the impact of the changes in the telecommunications market identified by APCC and the RBOC Coalition on the public's demand for payphone services. In 1999, before the recent changes in "wireless penetration and affordability," *RBOC Petition*, Attach. at 10, the Commission adopted a "marginal" payphone approach to preserve the number of payphones then deemed necessary to meet consumer demand. Now that consumer demand for payphone services has decreased, it follows that the number of payphones necessary to meet that demand also has decreased. However, the drastic rate increases sought in the petitions would result in an accelerated decrease in deployment of payphones because substantial rate increases undoubtedly would lower consumer demand for payphone services.

Given these changes in market conditions, the Commission should resist APCC and the RBOC Coalition's invitation to double the default compensation rate by "updating" the inputs based upon their submissions. Instead, the Commission should reassess its marginal payphone methodology in light of the submissions by APCC and the RBOC Coalition. In particular, in the *Third Report & Order*, the Commission (based on RBOC data) found that a marginal payphone location had a call volume of 439 calls. *Third Report & Order* ¶ 147. Further, the Commission explained that a marginal payphone location is a location "where the

⁸ *Third Report & Order* ¶ 230. As the Commission explained, parties "may petition the Commission regarding the default amount, related issues pursuant to technological advances, and the expected resultant market changes." *Id.*

payphone operator is able to recoup its costs, including a normal rate of return on the asset, but is unable to make payments to the location owner.” *Id.* ¶ 139. In this proceeding, Petitioners argue that the costs associated with a marginal payphone have remained essentially static, but (in an effort to increase the per-call compensation) they contend that the number of payphone calls necessary to satisfy these essentially static costs has been reduced substantially. See *APCC Petition* at 13 (234 calls); *RBOC Petition* at 12 (219 calls at marginal station).

Although Petitioners abandon the Commission’s own methodology for determining the volume of calls at a marginal payphone location, they never explain, as a matter of economics, the basis for their conclusion that the volume of calls needed to support a marginal payphone location has fallen even though, in their view, costs have remained largely unchanged.⁹ Given that they contend that the costs associated with a marginal payphone have remained largely unchanged (and because the default compensation rate has remained essentially static), the number of calls necessary to make a payphone “marginal” should not have changed to the extent petitioners suggest.¹⁰

Further, the Commission should seek comment on whether its continued use of a marginal payphone methodology under current market conditions properly implements the mandate of Section 276 or whether another methodology would better serve the statute’s goals of

⁹ In fact, as even Petitioners’ own estimates confirm, a number of their costs have fallen significantly. See *RBOC Petition* at 8 (coinless maintenance costs fell 26.9%); *id.* at 9 (SG&A costs fell by 22%); *APCC Petition* at 12 (arguing that some payphone costs have “decreased” while others have increased). Nevertheless, petitioners add back many of these costs reductions by incorporating additional costs components that the Commission previously rejected. *RBOC Petition* at 10-11 (bad debt and collection costs); *APCC Petition* at 13-14 & n.20 (bad debt and collection costs).

¹⁰ In Part II, AT&T explains why petitioners’ call volume and cost assumptions are erroneous and inconsistent with the *Third Report & Order*.

ensuring deployment of public phones “for the benefit of the public.” 47 U.S.C. § 276(b)(1). Even accepting Petitioners’ claims that the number of payphones is decreasing, the Commission closely should assess how many phones have been removed from service as well as the circumstances surrounding their removal. Removal of payphones from a location may be justified by a lack of consumer demand without any adverse impact on the general public. For example, there would be no obvious impact on the general public if (i) in an airport or shopping mall, the number of payphones at a given location is reduced from 8 to 5 based upon a decrease in consumer demand, or, (ii) on a street corner, the number of payphones were reduced from 3 to 2 payphones where consumer demand no longer justifies the additional payphone.

Section 276 cannot be interpreted to require the Commission to regulate in a manner that requires higher levels of deployment than can be justified by consumer demand. In making these assessments, the Commission should seek input from relevant state regulatory bodies regarding their experience with payphones and their views regarding the current levels of payphone deployment in their States.

II. THE COMMISSION SHOULD REJECT THE PROPOSALS BY THE RBOC COALITION AND APCC BECAUSE THEY ARE BASED UPON IMPROPER AND UNRELIABLE DATA.

In all events, the Commission should reject the efforts by the RBOC Coalition and APCC to more than double the default payphone compensation rate. Although Petitioners purport to adhere to the “marginal” payphone methodology from the Commission’s *Third Report & Order*, their petitions depart in significant ways from the Commission’s approach. For example, Petitioners acknowledge, and then ignore, the manner in which the Commission determined the volume of payphone calls at a marginal payphone in the *Third Report & Order*. Similarly, Petitioners’ joint and common cost analyses depart in significant ways from the approach reflected in the *Third Report & Order*. As a result, it comes as no surprise that the

bottom-up default rates proposed by Petitioners cannot be justified when compared, as the Commission did in the *Third Report & Order*, to the default compensation rates that would be generated using a top-down methodology.¹¹

A. The Call Volume Estimates Proposed By Petitioners Are Not Based Upon The Methodology Reflected In The Third Report & Order.

In the *Third Report & Order*, the Commission defined a “marginal payphone location” as “a location where the payphone operator is able to recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner.” *Id.* ¶ 139. The Commission then adopted a call volume based upon the midpoint between “the number of payphone calls that must be placed in order for the premises owner to not have to pay the LEC PSP for the payphone” and “the number of payphone calls that must be placed in order for the LEC PSP to begin paying a location payment to the premises owner.” *Id.* ¶ 147. Using this approach, the Commission endeavored to estimate the call volume at a payphone that “generates sufficient revenue to pay for itself.” *Id.* ¶ 146. The Commission’s analysis was affirmed on appeal. *American Public Communications Council v. FCC*, 215 F.3d 51, 57-58 (D.C. Cir. 2000) (explaining that a marginal payphone is one “that breaks even”). As demonstrated below, the “marginal” payphone call volumes provided by Petitioners cannot be reconciled with the Commission’s approach.

1. APCC’s Call Volume Estimates Are Based Upon A Survey That Is Fundamentally Flawed And Should Be Rejected.

APCC tentatively concludes that payphone call volumes at marginal payphones have fallen “by nearly half, to 234 from 439.” *APCC Petition* at 13. That determination is based

¹¹ As the Commission stated in its *Third Report & Order*, “[W]e have performed a top-down calculation to validate that our bottom-up methodology is reasonable. Similarly, the Commission in the *Second Report and Order* undertook a bottom-up calculation to validate the reasonableness of a top-down methodology.” *Third Report & Order* ¶ 192.

upon a cost study generated through a survey that asks a “series of questions concerning whether any commissions are currently paid by the independent PSP to the location owner.” *Id.* at 12. As APCC explains, it identified a set of “marginal payphones,” which APCC defines as “those for which no commissions are paid to the location owner.” *Id.* In doing so, APCC recognizes the importance of reflecting the “actual . . . calls made from . . . marginal payphones, as required under the Commission’s *Third Report & Order* methodology.” *Id.* APCC’s approach is fundamentally flawed in at least two respects.

First, as discussed above, the Commission has defined a marginal payphone location as “a location where the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner.” *Third Report & Order* ¶ 139. Accordingly, there are *two* criteria that make a payphone at a given location a “marginal” payphone: (1) the payphone owner is “unable to make payments to the location owner,” and (2) “the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset.” *Id.* The second criteria is essential because the Commission made clear that its approach was “not designed to make every payphone profitable.” *Id.* ¶ 79. Indeed, as the Commission explained, “[p]ayphones with sufficiently low call volumes or sufficiently high costs will not be profitable, regardless of the compensation amount we establish.” *Id.*

APCC’s proposal, however, is based upon a survey that defines “marginal payphones” solely as “those for which no commissions are paid to the location owner.”¹²

¹² *APCC Petition* at 12; see also APCC’s Petition, Per Call Cost Study for Dial-Around Calls at 5 (“Results are reported for these ‘marginal payphones’ (the average per-payphone costs and average number of calls at payphones for which no commissions are paid to the premises owner)”).

Although the absence of commissions from the payphone owner to the premises owner is a *necessary* element of identifying a marginal payphone location, that criteria is not by itself sufficient because it fails to confirm that the payphone is one that allows the payphone owner to “recoup its costs, including earning a normal rate of return,” *Third Report & Order* ¶ 139, or, as the D.C. Circuit explained, “a payphone that breaks even,” *APCC v. FCC*, 215 F.3d at 57. As explained by Dr. Robert M. Bell, APCC’s study has skewed its results by failing to eliminate from its survey sample payphones that do not allow the owner to “recoup its costs, including earning a normal rate of return.” *Third Report & Order* ¶ 139; see Declaration of Dr. Robert M. Bell, ¶ 11 (“Bell Decl.”) (Attachment A).

Put another way, APCC’s survey does not exclude the unprofitable payphones with “sufficiently low call volumes or sufficiently high costs” that “will not be profitable, regardless of the compensation amount [the Commission] establish[es].” *Third Report & Order* ¶ 79; Bell Decl. ¶¶ 11-12.¹³ Indeed, the Commission, in the *Third Report & Order*, was careful to account for this problem by determining the average number of payphone calls at a marginal location as the midpoint between the “the number of payphone calls that must be placed in order for the premises owner to not have to pay the LEC PSP for the payphone” and “the number of payphone calls that must be placed in order for the LEC PSP to begin paying a location payment to the premises owner.” *Id.* ¶ 147. As a result, APCC’s survey does not accurately reflect the

¹³ Nor does APCC make clear that it has excluded from its survey sample semi-public payphones for which the payphone owner receives a rent from the premises owner. Bell Decl. ¶ 11. Although its survey questionnaire includes one question that asks whether the payphone owner “receives any compensation from the location provider to maintain or service this ANI,” *APCC Petition*, Attach. at D.5.3, APCC never states that a positive answer on this question would exclude a payphone from its analysis, Bell Decl. ¶ 11.

call volumes associated with marginal payphones as contemplated by the *Third Report & Order*. Bell Decl. ¶ 12.

Specifically, the survey's failure to exclude unprofitable low-volume phones results in a call count at APCC's "marginal" payphone that is lower than it would be if calculated correctly. *Id.* For example, as explained by Dr. Bell, assume that 50 percent (54 of the 108) of the payphones classified as marginal were classified correctly, while 50 percent (the other 54) failed to recoup costs, so that they were not truly marginal. In addition, assume that the average number of calls per month for the former group was 400 and for the latter group was 68. In this hypothetical, the average number of calls across all 108 payphones would be 234 (the same as in the APCC study). However, the correct average, that for the 54 truly marginal payphones, would be 400, a number more than 70 percent higher than the number currently proposed by APCC.

Bell Decl. ¶ 12.¹⁴

Second, even if APCC's survey were valid and reliable – and it is not – its call volumes are understated by an unknown amount because APCC admits (in a footnote regarding its discussion of marginal payphone costs) that it did not include all completed calls in determining the call volumes at a "marginal payphone." *APCC Petition* at 13 n.20. APCC has reduced its call volume numbers by "utilizing only *paid* dial-around calls in determining the call

¹⁴ Dr. Bell has identified other significant errors in the APCC study. First, as Dr. Bell explains, the response rate to APCC's survey was less than 50 percent (408 of 940). This high non-response rate may have biased the results of the survey, since certain types of payphone operators might have been more likely to respond than others. Bell Decl. ¶¶ 13-14. Second, the subjects of the survey had direct interests in its outcome. Survey respondents—and nonrespondents—stood to benefit if the APCC study showed a low volume of calls and high costs. *Id.* ¶ 14. Finally, the APCC Study provides no indications about the size of sampling variability among its geographically stratified sub-samples. *Id.* ¶ 15. There is therefore no means of determining how far off the estimated average sample size might be. *Id.*

volumes generated at a marginal phone.” *Id.* APCC purports to justify this reduction in call volume as a way to address the problem of “bad debt.” *Id.* That approach is indefensible.

In the *Third Report & Order*, the Commission calculated marginal payphone call volumes by examining the total number of such completed calls at a “marginal” payphone. *Third Report & Order* ¶ 146. The Commission did not reduce this volume to adjust for the number of calls for which payphone providers argued that they had not been paid. *Id.* To the contrary, the Commission rejected efforts to include claims of “bad debt” in its analysis because, among other things, “PSPs that ultimately recover their uncollectibles from delinquent carriers would then double-recover: once from the debtor and once from the consumer, *i.e.*, through the cost element included in the compensation amount.” *Id.* ¶ 162. That conclusion was affirmed on appeal. *APCC v. FCC*, 215 F.3d at 55-56.

In light of these decisions, APCC’s improper efforts to inject its bad debt estimates into its volume analysis without any acknowledgement or explanation that “bad debt” has been deemed irrelevant underscores the lack of credibility of APCC’s entire methodology.

2. *The RBOC Coalition’s Call Volume Estimates Are Similarly Flawed.*

The RBOC Coalition’s estimates of payphone call volumes are similarly flawed. In its Petition, the RBOC Coalition argues that the Commission should “continue to calculate the dial-around rate by calculating the call volume at the ‘marginal payphone location,’” but then contends that the Commission’s methodology for determining the volume of calls at a marginal payphone should not be used here. *RBOC Petition* at 4. The Coalition does not contend that the data that it previously provided to the Commission are no longer available. Nor can the Coalition dispute that the D.C. Circuit affirmed the approach that the Commission adopted to calculate the marginal payphone volume. *APCC v. FCC*, 215 F.3d at 57-58. Instead, the

Coalition proposes an entirely new methodology that cannot be reconciled with the *Third Report & Order*.

Specifically, the Coalition's methodology uses not only call volumes at marginal payphone locations, but also call volumes for (i) payphones for which the premises owner pays a rent, and (ii) payphones for which the premises owner collects a rent. *RBOC Petition* at 5. In the *Third Report & Order*, however, the Commission ruled that the volume of calls at a marginal payphone location should *exclude* call volumes for locations where premises owners pay or receive rents and should instead reflect only the call volume at "a location where the payphone operator is able to just recoup its costs." *Third Report & Order* ¶ 139. Further, the RBOC Coalition, like APCC, makes no effort to exclude from its estimates payphones that currently do not "recoup [their] costs." *Id.* As noted previously, inclusion of such payphones results in a call volume that is lower than it would be if calculated under the Commission's existing standards. As a result, the RBOC Coalition's approach violates central tenets of the *Third Report & Order*.¹⁵

Simply put, the Coalition cannot argue that the Commission should adhere to the "marginal" payphone approach adopted in the *Third Report & Order*, but then propose a methodology for determining "marginal" payphone calling volume that undermines the *Third Report & Order*.

¹⁵ Further, the Coalition's efforts to adjust its calculation for its inclusion of payphones that earn a rent from premises owners and payphones for which premises owners demand locational rents further exacerbates its error. Specifically, the Coalition treats the payments that it makes to premises owners as a cost that is recovered by calls over-and-above the marginal payphone volume. But the Commission has concluded that "locational rents should be treated as a form of

B. Petitioners' Joint and Common Payphone Cost Estimates Are Based Upon An Analysis That Is Inconsistent With The Commission's Prior Orders.

In the *Third Report & Order*, the Commission adopted a bottom-up approach to determining joint and common payphone costs for the purposes of calculating default payphone compensation. *Third Report & Order* ¶ 72. Petitioners purport "to duplicate as closely as possible the requirements and mechanisms set forth in the *Third Report & Order*." *RBOC Petition* at 6; *APCC Petition* at 2 ("APCC does not propose any major departure from the cost model that the Commission developed in the *Third Report & Order*"). As demonstrated above, APCC's estimates are based on a survey that is fundamentally flawed, so APCC's cost estimates must be rejected for that reason alone. Moreover, an examination of the Petitions reflects that they depart in significant ways from the analysis that the Commission has employed in the *Third Report & Order*.

1. A Cost Component For Bad Debt Is Inconsistent With The Third Report & Order.

The RBOC Coalition contends that "bad debt" should be included in payphone costs. *RBOC Petition* at 10 (arguing that "bad debt" results in "a cost of \$0.028 per call"). The Coalition acknowledges that "the Commission declined to include bad debt in its cost calculations" but argues that "PSPs have collected much more reliable data relating to bad debt" and therefore "bad debt" should now be included as a compensable cost. *Id.* This argument should be rejected for two reasons.

First, although the Commission's previous rejection of "bad debt in its cost calculation" was based in part on "insufficient information," that was not the only or even the principal reason that the Commission rejected this cost component. The Commission explained

profit rather than a cost." *Third Report & Order*, ¶ 37 n.72.

that (i) “the recent history of per-call compensation payments is not an accurate guide for future levels of bad debt,” (ii) it did “not know the percentage of uncollected per-call compensation that is due to billing errors of the PSPs, as opposed to unscrupulous carriers,” and (iii) “PSPs that ultimately recover their uncollectibles from delinquent carriers would then double-recover.”

Third Report & Order ¶ 162. This analysis, in turn, was affirmed on appeal. *APCC v. FCC*, 215 F.3d at 56 (affirming Commission’s refusal to include bad debt element where “[t]he plight of the allegedly uncompensated payphone service provider does not equate to that of a merchant pursuing deadbeat customers in the marketplace”).

The Coalition’s claim that PSPs “have collected much more reliable data,” *RBOC Petition* at 10, does not purport to address the Commission’s concerns regarding “double recovery” or whether the bad debt is attributable “to billing errors of the PSPs.” Moreover, even if PSPs have more accurate historical data relating to bad debt, there has been no showing that these historical data are “an accurate guide for future levels of bad debt,” *Third Report & Order*, ¶ 162, especially where, as the D.C. Circuit has explained, “the factors affecting that data may change in the future,” 215 F.3d at 56.

Second, the RBOC Coalition’s “bad debt” estimates should be excluded because inclusion of that cost component would require some IXC’s to pay the debts of other IXC’s. But the Commission has recently confirmed that Section 276, as construed by the D.C. Circuit, does not permit the Commission to “require one company to bear another one’s expenses.”¹⁶ In doing so, the Commission rejected efforts to “shift the burden of paying outstanding . . . per-phone

¹⁶ *In re Implementation of the Pay Telephone Reclassification & Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Fifth Order on Reconsideration & Order on Remand, ¶ 82 (rel. Oct. 23, 2002) (“*Fifth Order*”) (citing *Illinois Pub. Telecomm. Ass’n v. FCC*, 117 F.3d 555 (D.C. Cir. 1997)).

compensation to IXCS that paid,” concluding that such an approach would be “unfair and inequitable and would violate the principle in the *Illinois* case.” *Fifth Order on Reconsideration*

¶ 83. Neither the RBOC Coalition nor APCC provides a basis for reconsidering the Commission’s exclusion of “bad debt” from the payphone cost calculations.

2. *A Cost Component For Collection Costs Is Inconsistent With The Third Report & Order.*

Both the RBOC Coalition and APCC seek to recover “collection costs,” even though the Commission rejected these arguments in the *Third Report & Order*. APCC admits that the Commission previously rejected this argument but contends that now “more than adequate information is available.” *APCC Petition* at 13. APCC’s argument misconstrues the Commission’s prior determination.

Previously, the Commission concluded that “the collection costs of dial around compensation are fairly represented by the [Sales, General, and Administrative Costs (SG&A) costs] portion of joint and common costs.” *APCC v. FCC*, 215 F.3d at 57. The Commission reasoned that there was “insufficient information on the record to determine the extent to which administrative costs vary when the number of coinless calls increases relative to coin calls.” *Third Report & Order*, ¶ 164. Here, neither APCC nor the RBOC Coalition provide sufficient information to undermine the conclusion that collection costs already are fairly represented by the SG&A portion of joint and common costs or to allow a determination of the extent to which such costs “vary when the number of coinless calls increases relative to coin calls.” 251 F.3d at 57. As a result, Petitioners’ efforts to recover “collection costs” should be rejected.

3. *Petitioners’ Interest Calculations Are Flawed.*

Finally, APCC and the RBOC Coalition both contend that they are entitled to recover “interest for a four-month time lag prior to payment . . . calculated in accordance with

the *Third Report & Order*, based on an annual rate of 11.25%.” *APCC Petition*, Attach. 1 at 8; *RBOC Petition* at 11 (same). The *Third Report & Order* incorporated an interest component equivalent to “a total of four months of interest at 11.25 percent per year” and determined that “[i]f IXC’s are late in making their payments . . . interest on principal will continue to accrue at 11.25 percent per year,” *id.* ¶ 189. That determination, however, can no longer be justified in light of more recent Commission decisions.

In the *Fifth Order on Reconsideration*, the Commission rejected arguments that “the interest rate necessary to compensate PSPs for compensation delay must be set at a rate that reflects the cost of capital of local exchange carriers, 11.25%.” *Id.* ¶ 99. The Commission explained that application of the “IRS-prescribed interest rate” is designed to “reasonably capture the time value of money for all parties owed payment, and not to capture an appropriate return on invested capital.” *Id.* ¶ 100. Accordingly, the interest component of costs should be modified to reflect the IRS-prescribed rate of interest, rather than the cost of capital of a local exchange carrier.¹⁷

4. *Petitioners’ Tentative Cost Estimates Should Be Closely Scrutinized In Light Of Changing Market Conditions.*

APCC makes clear that its cost estimates are merely tentative, and therefore careful consideration of their current figures may be irrelevant when they develop additional cost data. Nevertheless, an analysis of APCC and the RBOC Coalition’s cost estimates must account for the changes in market conditions since the *Third Report & Order*. Specifically, to the extent that payphone providers have been compensated for almost seven years for capital costs

¹⁷ Although the Commission reinstated the 0.9 cent component to compensation attributable to interest, *Fifth Order on Reconsideration*, ¶ 31, AT&T submits that the Commission’s conclusion cannot be reconciled with its determination that interest payments should be designed to “capture the time value of money . . . and not to capture an appropriate rate for return on invested capital.” *Id.* ¶ 100.

associated with phones that they have in service, these capital costs should be reduced significantly because these phones, by now, have been almost fully depreciated. Further, if petitioners are correct that payphones have been removed from the market, then there are undoubtedly fully or partially depreciated payphones available to supply any need for a payphone in a specific location based upon consumer need. As a result, the capital costs associated with new payphones, if Petitioners' description of market changes is correct, should be substantially decreased.

C. Application of A Top-Down Methodology Confirms That Petitioners' Proposed Rate Increases Are Unsupportable.

Previously, the Commission performed a top-down calculation to validate that the bottom-up methodology that it employed in the *Third Report & Order* yielded a reasonable result. *Third Report & Order* ¶ 192. Application of that same analysis here makes clear that Petitioners' proposals are grossly excessive and will result in windfall profits to payphone providers that must be borne by IXC's and their consumers.

In the *Third Report & Order*, the Commission sought to validate the per-call compensation rate that the Commission derived from its bottom-up marginal cost and call volume calculations by comparing that rate to the rate derived using a top-down methodology. Using what commenters agreed was the "predominant local coin calling price in the United States," (i.e., \$0.35 per call), and then subtracting "the cost of the coin mechanism, termination charges, and coin collection charges," the Commission concluded that using a top-down approach, the default per-call rate would be \$0.23 per call, or "within a penny of the default amount arrived at under our bottom up approach." *Id.* ¶¶ 192, 193. The Commission explained that its top-down calculation was relevant because it "supports the reasonableness of the default compensation amount that [the Commission] adopt[ed]" in the *Third Report & Order*.

Application of this same analysis here demonstrates that Petitioners' proposed rate increases are wildly exaggerated and unreasonable. In particular, even if the RBOC Coalition were correct that the "unregulated" market price for a local coin call "has risen to \$.50" per call, *RBOC Petition* at 2, then the per-call compensation rate of \$0.49 and \$0.48 per call for coinless calls is plainly unsupportable. Petitioners contend that their common costs have remained largely static, and they provide no basis for concluding that their costs for coinless calls have changed since the *Third Report & Order*. Further, according to Petitioners, the call volume at marginal payphones has decreased, thereby increasing the per-call costs of coin payphone calls.

Using the RBOC Coalition's own call volume figures, and assuming, conservatively, that the percentage of coin calls has not decreased since 1998, and using average (rather than marginal) payphone call volumes, the cost of the installation of a coin mechanism would be \$0.109 per call.¹⁸ Similarly, the local termination charges would be \$0.038 per call. *Third Report & Order* ¶ 193. Finally, the collection charges would be \$0.074 per call.¹⁹ Taken together, and subtracted from the unregulated market rate of \$0.50 per call, a top-down approach yields a per call rate for coinless calls of \$0.279.²⁰ Furthermore, as the Commission recognized in the *Third Report & Order*, if a marginal call rate were used, the default compensation rate

¹⁸ The cost of installing a coin mechanism is \$17.02 per month. *Third Report & Order* ¶ 193. The number of coin calls is the average number of total calls (253) times the percentage of calls that are coin calls (61.5%, see *Third Report & Order*, ¶ 193 n.405), or 156 coin calls per month. The per coin-call cost of a coin mechanism is thus \$17.02/156, or \$0.109 per call.

¹⁹ Coin collection charges were \$11.59 per month. *Third Report & Order* ¶ 193 n.407. Thus, coin collection costs, divided by the 156 coin calls at an average payphone, amount to \$0.074 per coin call.

²⁰ \$0.50 (unregulated coin call charge) - \$0.109 (per call cost of coin mechanism) - \$0.038 (local termination charge) - \$0.074 (per call coin collection cost) = \$0.279 per coinless call.

“would be even lower.” *Id.* ¶ 193 n.405. Indeed, using the RBOC Coalition’s own estimated marginal payphone call volume estimates (219 calls per month), the top-down methodology yields a default rate for a coinless call of \$0.25 per completed call.²¹

CONCLUSION

For these reasons, the Commission should initiate a Notice of Inquiry to assess the impact of changing market conditions on the appropriate methodology for determining the default payphone compensation rate under 47 U.S.C. § 276. In all events, the Commission should reject the proposed modifications to the current default rate proposed by APCC and the RBOC Coalition because they are based upon fundamentally flawed data and analyses.

Respectfully submitted,

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Dated: October 30, 2002

²¹ Specifically, according to the RBOC Coalition, the number of coinless calls per month at a marginal phone would be (219) multiplied by the percentage of calls that are coin calls (61.5 %) or 134.7 calls coin calls per month. *See Third Report & Order* ¶ 193. As a result, the per call costs of the coin mechanism and coin collection would increase to \$0.126 and \$0.086 per coin call. The per call local termination costs would remain the same (\$0.038 per call).

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Comments of
AT&T Corp. was served, by the noted methods, the 30th day of October, 2002, on the following:

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Patricia Bunyasi

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)

RBOC Payphone Coalition Petition for)
Rulemaking To Establish Revised Per-Call)
Payphone Compensation Rate)

RM No. 10568

American Public Communications Council)
Request To Update Default Compensation Rate for)
Dial-Around Calls from Payphones)
_____))

DECLARATION OF ROBERT M. BELL

I. QUALIFICATIONS.

1. My name is Robert M. Bell. My business address is AT&T Labs-Research, 180 Park Avenue, Florham Park, New Jersey 07932.
2. I received a Ph.D. in Statistics from Stanford University in 1980.
3. From 1980 to 1998, I was Senior Statistician at RAND, a non-profit institution that conducts public policy analysis. While at RAND, I supervised the statistical design and/or analysis of many projects, including several large multi-site evaluations. I also headed the RAND Statistics Group from 1993 to 1995 and taught statistics in the RAND Graduate School from 1992 to 1998. In 1998, I joined the Statistics Research Department at AT&T Labs-Research, where I am a Principal Member of Technical Staff. My main research area is survey research methods.

4. I have authored or co-authored 50 articles on statistical analysis that have appeared in a variety of refereed, professional journals. I am a fellow of the American Statistical Association. I am currently a member of the Committee on National Statistics organized by the National Academy of Sciences as well as the Academy's Panel to Review the 2000 Census.

II. ANALYSIS OF PER-CALL COST STUDY FOR DIAL-AROUND CALLS SUBMITTED BY THE AMERICAN PUBLIC COMMUNICATIONS COUNCIL ("APCC").

5. I have reviewed the "Per-Call Cost Study for Dial-Around Calls" (APCC Study), submitted by APCC in connection with its Request that the Commission Issue a Notice of Proposed Rulemaking (Or in the Alternative, Petition for Rulemaking) to Update Dial-Around Compensation Rate (APCC Request).

6. The APCC Study purports to justify APCC's request for a significant increase in the default rate for dial-around payphone calls by claiming that the results of APCC's survey show that there has been a decrease in the call volumes at "marginal" payphone locations.

7. My understanding is that, in the *Third Report and Order*, the Commission defined a marginal payphone location as one where "the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner."¹ The Commission then established the default compensation rate for dial-around payphone calls by dividing the monthly joint and common costs for a typical payphone by the number of calls placed at a marginal location. *Id.* ¶ 191.

¹ Third Report and Order, and Order on Reconsideration of the Second Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd. 2545, 2607, ¶ 139 (1999) ("*Third Report & Order*").

8. The APCC Study claims to employ the same methodology. *See* APCC Study at 5 (“The Commission’s marginal location analysis is applied in this cost study.”). In reality, however, the APCC study is not faithful to the Commission’s approach. Instead, it uses a different methodology that skews downward the number of calls (and upward the resulting default rate).

9. In particular, according to the Commission’s definition, a marginal payphone must meet two conditions: (1) it recoups costs (plus a nominal rate of return), and (2) it does not earn enough to pay a commission to the location owner. *Third Report & Order* ¶ 139.

10. For the APCC Study, however, a payphone must meet only the second condition to be deemed “marginal.” *See* APCC Study at 5 (“Results are reported for these ‘marginal payphones’ (the average per-payphone costs and average number of calls at payphones for which no commissions are paid to the premises owner).”); APCC Petition at 12 (“Based on responses to those questions, 108 marginal payphones (i.e. those for which no commissions are paid to the location owner) were identified from among the 410 payphones for which responses were received. . . . Only those marginal payphones were used in the cost analysis underlying the rate proposed by this petition.”). The APCC Study did not further screen this group to ensure that it was analyzing only those payphones that recoup their costs.

11. Consequently, the survey sample of 108 payphones that the APCC Study labels as “marginal” contains not only phones the Commission would consider marginal, but also some unspecified number of payphones that may not currently recoup their costs. For example, some of the payphones may be “semi-public” phones that are subsidized by a premises owner

who wishes to provide a payphone for customers and pays rent to the payphone provider. *Third Report & Order*, ¶ 156.

12. This error is critical because the set of payphones that do not recoup their costs almost certainly has much lower call volumes on average than the set that APCC correctly classified as marginal. For example, assume that one-half (54 of the 108) of the payphones classified as marginal were classified correctly, while the other 54 failed to recoup costs, so that they were not truly marginal. In addition, assume that the average number of calls per month for the former group was 400 and for the latter group was 68. In this hypothetical, the average number of calls across all 108 payphones would be 234 (the same as in the APCC study). However, the correct average, that for the 54 truly marginal payphones, would be 400, more than 70 percent higher than the number APCC puts forward.

13. Above and beyond the almost certain bias resulting from APCC's error in identifying the marginal payphones, there are several other potential sources of bias. The response rate to the survey was only 43 percent (408 of 940). Nonresponse error "occurs when a significant number of people in the survey sample do not respond to the questionnaire *and* have different characteristics from those who do respond, when these characteristics are important to the study."² The large amount of nonresponse in the APCC survey means that there is the potential for large biases in the results of the survey. A second critical concern is measurement error for determining each of: whether a payphone paid any commissions, the operational costs, and the call volume. Those measures all need to have been collected in a reliable, unbiased manner.

² Don A. Dillman, *Mail and Internet Surveys*, at 10 (2d ed. 2000).

14. These concerns are heightened by the fact that the subjects of the survey had direct interests in its outcome. Survey respondents—and nonrespondents—stood to benefit if the APCC study showed a low volume of calls and high costs. It is critical that the behaviors of respondents (either the decision to respond or decisions about what to say) were not influenced by this incentive. Here, they were clearly aware of that incentive. The first sentence of the instructions informed potential survey respondents that the data were being collected to “develop a rate for dial around compensation to be proposed to the FCC.” APCC Study at D.5.2. Later, when respondents reached the questions on call volume, they were reminded “[t]he FCC methodology is based on the average number of all calls for a given ANI, including all call types.” APCC Study at D.5.3. The fact that survey respondents were aware that they stood to benefit from their survey answers regarding costs and call volumes further undermines the validity of the APCC Study.

15. Finally, the APCC Study provides no indications about the size of sampling variability. Although a quantification of sampling variability would not account for the other types of error discussed above, the authors still should have reported either a standard error or a confidence interval for the average call volume and for the average costs per payphone.

III. CONCLUSION.

16. The APPC Study is riddled both with known as well as likely errors that could bias the findings. Such errors include the erroneous inclusion of payphones that are not marginal, nonresponse error, and other potential measurement errors. Consequently, the APCC Study is insufficient to justify the rate increase that APCC seeks.

I, Robert M. Bell, declare under penalty of perjury that the foregoing is true and correct.

Robert M. Bell

Robert M. Bell

Executed on October 29, 2002